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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS:

Gary Pierce, Chairman  
Bob Stump  
Sandra D. Kennedy  
Paul Newman  
Brenda Burns

AZ CORP COMMISSION  
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IN THE MATTER OF THE APPLICATION OF  
ARIZONA PUBLIC SERVICE COMPANY FOR A  
HEARING TO DETERMINE THE FAIR VALUE  
OF THE UTILITY PROPERTY OF THE  
COMPANY FOR RATEMAKING PURPOSES, TO  
FIX A JUST AND REASONABLE RATE OF  
RETURN THEREON, AND TO APPROVE RATE  
SCHEDULES DESIGNED TO DEVELOP SUCH  
RETURN.

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) DOCKET NO. E-01345A-11-0224  
)  
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) **NOTICE OF FILING**  
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The Federal Executive Agencies (FEA), hereby provide notice of filing the direct rate design testimony of Larry Blank in the above referenced matter.

Original and 13 copies filed with Docket Control

Dated this 2nd day of December, 2011

Arizona Corporation Commission

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**BEFORE THE ARIZONA CORPORATION COMMISSION**

**COMMISSIONERS:**

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DOCKET NO. E-01345A-11-0224

**PREFILED TESTIMONY**

**OF**

**LARRY BLANK**

**ON BEHALF OF**

**THE FEDERAL EXECUTIVE AGENCIES**

**December 2, 2011**

**(Rate Design Phase)**



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**I. IDENTIFICATION**

**Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS FOR THE RECORD.**

A. My name is Larry Blank. My business address is Tahoeconomics, LLC, 2533 North Carson St., Suite 3624, Carson City, NV 89706. My email address is [LB@tahoecomonomics.com](mailto:LB@tahoecomonomics.com).

**Q. WHERE ARE YOU EMPLOYED?**

A. I am currently an Associate Professor of Economics and the Associate Director with the Center for Public Utilities in the College of Business at New Mexico State University ("NMSU"). For the purposes of this proceeding, I am engaged through *TAHOEconomics*, LLC, ("Tahoe"), a Nevada-registered consulting firm I founded in 1999, and for which I serve as principal. Tahoe specializes in most policy and ratemaking facets of regulated utility industries. The expert opinions expressed herein are my own and nothing in this testimony necessarily reflects the opinions of NMSU.

**Q. ARE YOU THE SAME LARRY BLANK WITH PRE-FILED TESTIMONY IN THE REVENUE REQUIREMENTS PHASE OF THIS CASE?**

A. Yes.

**II. PURPOSE AND SUMMARY**

**Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

A. I am testifying on behalf of the Federal Executive Agencies ("FEA") in response to two proposals in the rate design phase of the Arizona Public Service Company ("APS" or the "Company") application to adjust retail service rates. Specifically, these proposals are:



1. The APS proposal to eliminate the 90/10 incentive mechanism on the Power Supply Adjustment ("PSA") mechanism as sponsored by APS witness Peter Ewen.

2. The APS proposal to cease billing based on the unbundled rate elements as sponsored by APS witness Charles Miessner.

**Q. PLEASE SUMMARIZE YOUR TESTIMONY.**

A. First, I recommend that the Commission reject the APS proposal to eliminate the 90/10 sharing from the PSA. Instead, the Commission could retain the 90/10 incentive mechanism but modify the mechanism to limit the dollar amount of sharing with a \$20 million cap as I will describe in detail below.

Second, although FEA is not opposed to billing customers based on bundled rate elements, I recommend that the Commission order APS to continue to maintain its unbundled rate billing capabilities and to follow through on its stated commitment to provide customers the option to receive billing based on unbundled charges.

**III. APS PROPOSAL TO ELIMINATE THE 90/10 INCENTIVE IN THE PSA**

**Q. WHAT IS THE CURRENTLY APPROVED 90/10 INCENTIVE MECHANISM FOR THE PSA?**

A. As described on page 15 of Mr. Ewen's direct testimony, the 90/10 sharing provision allows APS to recover 90% of that portion of (most) fuel expenses that exceed the revenue collected through the Base Fuel Rate, and allows APS to retain 10% fuel cost savings when fuel expenses fall below the amount collected through the Base Fuel Rate. As stated by the Commission in Decision No. 69663 (pp. 106-107), the 90/10 sharing



1 provision is an “incentive mechanism” to “insure that APS is diligent in its fuel  
2 procurement.”

3 **Q. IN YOUR OPINION, DOES THE 90/10 SHARING OF INCREASES AND**  
4 **DECREASES IN FUEL COST CREATE A STRONG INCENTIVE FOR**  
5 **PRUDENT PROCUREMENT OF FUEL?**

6 A. Yes, I would characterize this as a strong incentive mechanism for those employees at  
7 APS responsible for fuel procurement with millions of dollars at stake (see e.g., Mr.  
8 Ewen’s Chart 1).

9 **Q. DO YOU BELIEVE THE COMMISSION’S DECISION TO IMPLEMENT THE**  
10 **90/10 INCENTIVE MECHANISM WAS A GOOD APPROACH?**

11 A. Because it is very difficult to regulate fuel and purchased power procurement activities  
12 under the traditional regulatory process, the 90/10 sharing serves as a novel and balanced  
13 approach to create financial incentives for the adoption of prudent procurement strategies.  
14 However, the Company cannot be expected to perfectly control realized fuel costs with  
15 its portfolio strategies and cannot guarantee that the over- and under-recoveries net each  
16 other out over the long term. Even the best procurement practices cannot control the  
17 market forces determining natural gas prices. Therefore, if the Commission is  
18 considering a modification to this mechanism, it may want to consider limiting the dollar  
19 amount of the sharing with an absolute dollar sharing cap.

20 **Q. IF THE COMMISSION CONSIDERS A MODIFICATION TO IMPLEMENT A**  
21 **SHARING CAP, WHAT WOULD YOU PROPOSE?**

22 A. For the purpose of shielding the Company and customers from any extraordinary changes  
23 in market fuel prices, I recommend that the Commission limit the sharing amount to not



1 exceed \$20 million per year. In other words, when fuel expense exceeds Base Fuel Rate  
2 revenue by more than \$200 million, the Company would be allowed to recover \$180  
3 million (90%) plus all amounts in excess of \$200 million. On the other hand, if the fuel  
4 expense fell by more than \$200 million, the Company would retain \$20 million from the  
5 Base Fuel Rate revenues, but the amounts in excess of \$200 million would be credited to  
6 customers. The \$200 million target is less than 30% of the applicable 90/10 amounts  
7 included in the Company's proposed Base Fuel Rates (see Attachment PME-3, p. 3 of 4,  
8 to Mr. Ewen's Direct), and the \$20 million cap on the sharing component represents 10%  
9 of the \$200 million amount. The \$20 million represents the maximum potential loss or  
10 gain that the Company will realize under the 90/10 sharing mechanism.

11 **Q. DOES THE MAXIMUM POTENTIAL LOSS OR GAIN OF \$20 MILLION**  
12 **CREATE A SUFFICIENT INCENTIVE TO ENCOURAGE PRUDENT**  
13 **PROCUREMENT EFFORTS AND STRATEGIES?**

14 A. I would hope so. The goal of the 90/10 sharing mechanism should be to create proper  
15 procurement incentives, not to create excessive windfalls for the Company or customers.  
16 I believe my recommended sharing cap of \$20 million accomplishes this goal.

17 **Q. SHOULD YOUR PROPOSED MODIFICATION TO THE 90/10 SHARING**  
18 **ALTER THE ADJUSTED FUEL EXPENSES INCLUDED IN THE COMPANY'S**  
19 **PROPOSED BASE FUEL RATES?**

20 A. No. The adjustments for known and measurable changes continue to be relevant for the  
21 base rates regardless of whether the Company's request to eliminate the 90/10 sharing is  
22 adopted or not.



1 **Q. WHAT IS YOUR RECOMMENDATION ON THE 90/10 SHARING**  
2 **MECHANISM?**

3 A. I recommend that the Commission reject the APS proposal to eliminate the 90/10 sharing  
4 from the PSA. Instead, the Commission could modify the incentive mechanism to limit  
5 the dollar amount of sharing with a \$20 million cap as I describe in detail above.  
6

7 **IV. APS PROPOSAL TO REMOVE UNBUNDLED ELEMENTS FROM BILLS**

8 **Q. DOES THE FEA OPPOSE THE COMPANY'S PROPOSAL TO USE BUNDLED**  
9 **RATHER THAN UNBUNDLED RATE ELEMENTS FOR BILLING PURPOSES?**

10 A. No; however, I recommend that the Commission order APS to continue to maintain its  
11 unbundled rate billing capabilities and to follow through on its stated commitment to  
12 provide customers the option to receive billing based on unbundled charges. The details  
13 provided with unbundled billing can be useful for customers who desire more  
14 transparency in billing. On the other hand, the FEA supports those customers who prefer  
15 simplified billing.

16 **Q. HAS THE COMPANY INCLUDED THE UNBUNDLED BILLING OPTION IN**  
17 **ITS PROPOSED TARIFF REVISIONS?**

18 A. The Company's proposed tariff rate schedules continue to include the Unbundled  
19 Standard Offer Service rates, but I do not see language that specifies that a customer must  
20 request this option. Nonetheless, the Company has made this commitment in their  
21 application and my recommendation is as stated above.  
22



Prefiled Testimony of Larry Blank  
On behalf of the Federal Executive Agencies  
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1    **Q.    DOES THIS CONCLUDE YOUR TESTIMONY?**

2    **A.    Yes.**